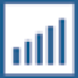
LEGACY

ECONOMIC AND FINANCIAL DIGEST
A NEWSLETTER FOR LEGACY INVESTORS

January 2018

The Tortoise and The Hare

As the curtain descends on an eventful 2017, the spotlight shifts to a new year. The first act looks promising, as the economy is entering 2018 with considerable momentum. Consumers reopened their wallets and purses during the winter months after taking a breather in the third quarter. Households struck a festive chord in November and retailers enjoyed a banner month of sales. With confidence sky-high and the job market generating healthy payroll growth, consumers likely imparted a muscular contribution to the economy's overall growth rate in the fourth quarter.

Consumer spending, of course, is the main driver of the nation's growth engine, accounting for 70 percent of total activity. But the economy needs to run on more than one cylinder if it is to embark on a long journey, and households do not have the firepower to keep it running alone. Happily, other parts of the engine are kicking in. *Continued next page*

Advice for this Year's Tax Reform

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January is a great time to take stock of where you currently are from a financial, tax, and estate plan perspective. With the new tax reform bill officially signed into law, this is especially good advice this year. Here are five things to do in the next few months:

1. Assess the impact of the new tax reform law on your 2018 income taxes. Most of the provisions of the new law will begin to affect everyone's income taxes in 2018. Overall federal income tax rates will be lower for 2018, but many deductions and income tax credits are reduced or eliminated. The IRS is scheduled to come out with new income tax withholding tables in February which are designed to take into consideration the new income tax rates and standard deduction, although the new withholding tables do not necessarily take into consideration taxpayers who itemize deductions. Therefore, when you sit down with your tax preparer to do your 2017 income tax return, be sure to also review your current income and tax deductions. Ask him or her to analyze what amount of income tax you should withhold in 2018, not only on your wages and estimated tax withholding payments, but also on distributions from your IRAs and 401ks. Look at which deductions and income tax credits you currently take and review the effect of the new tax law on those alongside your overall income tax scenario. With a better understanding of how the new tax law affects your personal tax scenario, you may have less of a surprise when you file your income tax returns in April 2019.

2. Assess the impact of new tax reform law on your estate and financial plan. The new tax reform law increased the federal estate and gift tax exemptions to $11.2 million per person while retaining the ability to use any unused estate tax exemption for the surviving spouse's estate. If you haven't looked at your estate plan lately, now is the time to sit down with your attorney and review your estate plan to make sure it is up to date. Even though these new exemption increases are temporary, you may find that your estate plan has provisions that do not coincide with current law or no longer reflect your wishes. Generally, you should review your estate plan every three to five years or when you have experienced a major life event in your family (divorce, death, birth of a child, retirement, etc.). Because of the tax law changes, 2018 is an ideal year to review these provisions.

3. Consider creating a financial plan. Remember that the estate tax exemption applies to the value of your estate upon your death—which hopefully is many years from now—not the value of your estate today. If you are unsure of the probable value of your estate years down the road, ask your relationship manager about creating a financial plan. Developing a financial plan can help you meet both your financial and life goals (funding for retirement or college expenses, valuations for estate tax planning, funding for long term care, and charitable funding, etc.). Since financial planning begins by looking at your current financial situation, spring is an ideal time because you receive annual reports and valuations on most of your assets in the first couple of months of the year. Financial planning is one of the services that Legacy offers its clients.

4. Review and update your financial and health power of attorney (POA) documents. Make sure that both your financial and health power of attorney documents reflect your wishes and your assets. Confirm that the agents you listed are still the people you want to act on your behalf. Be sure to give a copy to your POA, or that your POA knows where to find them.

5. Review and update your beneficiary designations on your life insurance, IRAs, and 401k plans. Your beneficiary designations, not your will or trust, will govern how your life insurance, IRA, and 401k plans will be distributed. Therefore, it's important that your beneficiary designations are up to date and reflect your wishes. Be sure to list a primary and contingent beneficiary on these accounts and a provision to handle beneficiaries who are minors (under the age of majority). Your beneficiary designations should work in conjunction with your overall estate plan, therefore when you review your estate plan, it is an opportune time to review your beneficiary designations, too. Also be sure to keep copies of your beneficiary designations with your estate planning documents (will, trust, marital property agreement, financial power of attorney, and health care power of attorney documents).

The Tortoise and The Hare

Continued from front page

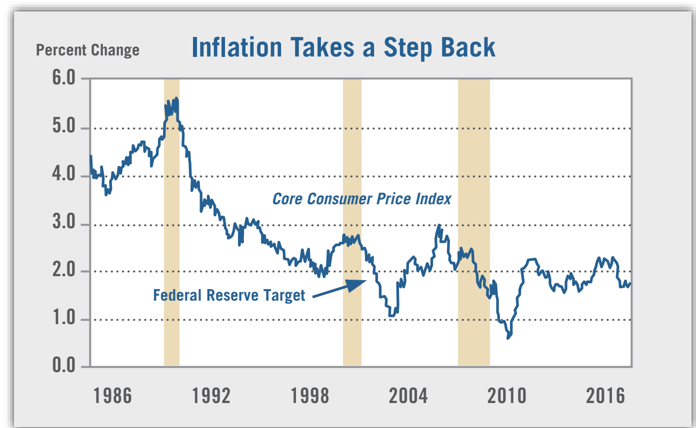
The revival in business investment that began a year or so ago is picking up momentum, underpinned by record profits, shrinking capacity, elevated business optimism and worker shortages. Additional impetus will come from the recently-passed corporate tax cuts. Housing activity is also perking up, with home sales fueled by the strong job market, rising incomes, and increased household formation. The major restraint in this sector is coming from the supply side where builders are having trouble finding qualified workers and land. Our overseas partners are also providing economic fuel. For the first time since the Great Recession, growth is synchronized across all major economies, stoking demand for American products.

Against this backdrop, there is a high probability that 2018 will be recession-free. If so, that would mark 114 months of continuous growth, a stretch of prosperity exceeded only once before. Should the upturn extend for six more months into 2019, it would become the longest expansion on record, exceeding the 120 months set in the 1990s. Some growth-killing event could intervene between now and then, but barring an external shock there is a good chance this expansion has the legs to accomplish that record-setting feat. The primary internal threats that doomed past expansions–speculative excesses or disastrous policy mistakes–are not apparent, at least not yet. True, at 2.3 percent, the average growth of the expansion has been the weakest on record. But the slow-moving nature of this lengthy recovery has suppressed imbalances and kept the Federal Reserve from making drastic policy moves. With fiscal stimulus about to kick growth up another notch, will the hare overtake the tortoise and make 2018 more vulnerable to a policy mistake?

Missed Calls

Yogi Berra famously said that making a prediction is difficult, especially about the future. To their credit, however, economists in general got 2017 reasonably correct. Modest growth was expected, and that's what we got, with GDP advancing by another ho-hum pace of slightly over 2 percent. But the headline trend masks some dramatic misses in the underlying details. While unemployment fell much more than expected, the big miss was on inflation, which the majority of economists (and policymakers) thought would be ramping up.

Indeed, at the start of year, the big bet on Wall Street was on the so-called "reflation trade". With the economy nearing full employment at the end of 2016 and the expansion moving into a mature stage, the widespread perception was that the time-honored sequence of rising wages, inflation and bond yields would naturally follow. That, in turn, would tamp down



the rally in stocks, which delivered another solid gain of around 10 percent in 2016, partly in response to historically low interest rates that encouraged investors to buy riskier assets.

Of course, nothing of the sort occurred. While the job market tightened, wages failed to respond. At the end of 2016, average hourly earnings of all workers in the private sectors had increased by 2.9 percent over the previous twelve months. By November of 2017, the annual rate of increase had fallen to 2.5 percent. With labor costs (a major source of price pressure) held in check, so too was inflation. The core inflation rate actually fell by 0.5 percentage point, from 2.2 percent to 1.7 percent between the end of 2016 and November 2017. And with inflation dormant, bond yields hardly changed over the course of 2017; the 10-year Treasury yield in late December held at around the same 2.40-2.50 percent it started the year. Rounding out the missed calls for 2017, stock prices once again roared ahead, this time more than doubling the gains made in 2016.

Sticking With The Plan

The Fed was just as culpable as private economists in missing the inflation call and, by implication, the market response, as it doesn't explicitly forecast market-determined yields and stock prices. Like most private economists, the majority of Fed officials thought wages and inflation would respond to the ever-tightening job market, a relationship that is captured by the so-called Phillips curve. But while the unemployment rate fell more steeply than the Fed envisioned, the inflation rate remained stubbornly below its long-standing 2 percent target.

To be fair, the Fed did not expect inflation to hit 2 percent in 2017, only to start moving up towards the target. The central bank didn't waver in that conviction even as the trend moved in the opposite direction. For the most part, policy makers forgave that recalcitrant behavior by blaming transitory factors for pulling inflation down. The most notable of those was the

astonishing freefall in the prices of cell phone plans reinforced by a mysterious slowdown in medical costs.

As a result, the Fed stuck to its plan to gradually lift short-term interest rates, believing that once the transitory forces ebbed, the Phillips curve would kick in and spur higher inflation. As unemployment fell further, that conviction hardened and served to justify the three-quarter point rate increases put into effect during the year, including the last hike at the December policy meeting. But by late in the year, even the Fed admitted that it was befuddled by the persistence of low inflation and wondered if something more fundamental than transitory forces were responsible. A growing minority among Fed officials wanted to proceed more cautiously in lifting rates, preferring to wait for actual evidence that inflation is increasing before stepping on the monetary brakes.

Policy Implications

At its December meeting, the central bank reaffirmed its commitment to gradually lift rates, expecting to hike three more times in 2018. Although internal resistance to that plan grew, including two Fed officials that actually voted against the December rate increase, the decision to move ahead was influenced by the ongoing strength in the labor market and the improved outlook for the upcoming year. Accordingly, the Fed revised up its 2018 growth forecast to 2.5 percent from the 2.1 percent estimate made three months earlier, in part reflecting the fiscal stimulus from the just-enacted $1.5 trillion tax cut.

Paradoxically, while the Fed upgraded its growth outlook, it did not change the inflation forecast; it still expects the inflation rate to remain under the 2 percent target until 2020. One way to interpret this incongruity is that the policy makers are willing to let the economy run hotter than otherwise in light of the reduced sensitivity of inflation to growth. By this reckoning, stronger growth will not trigger more rate hikes unless it stokes a quicker inflation response than it has in recent years. The plan to hike rates three times in 2018 is unchanged from the prediction made in September, despite the upward revision to the growth forecast.

This interpretation conflicts with the way monetary policy unfolded in 2017, which may portend a more aggressive rate strategy in 2018. Keep in mind that the Fed increased short-term rates three times over the course of the year even though the inflation rate actually fell. Simply put, it placed more emphasis on the economy's performance and, in particular, the job market, both of which are expected to strengthen in 2018. If, as expected, inflation also firms up along with strengthening underlying fundamentals, it seems reasonable to expect that the Fed will be more aggressive in hiking rates than it was in 2017.

More Hawks Calling The Shots

That prospect becomes more compelling because the committee that makes interest rate decisions will undergo a significant changing of the guard in 2018. Thanks to the annual rotation of four voting members on the Federal Open Market Committee, the four new members will have a more hawkish inflation bias than the ones they replace. This new mix may well be more trigger-happy in lifting rates if the economy and job market continue to outperform expectations, even if inflation is slow to perk up.

As a result, the odds that monetary policy will tighten too aggressively in the year ahead have increased, reminiscent of overreactions that short-circuited previous expansions. The threat looms larger because last-minute changes in the tax bill front-load about $200 million of *Continued next page*

Legacy Team Spotlight

Kay Bahn, Support Services Specialist
P 920.967.5020

Meet Kay Bahn

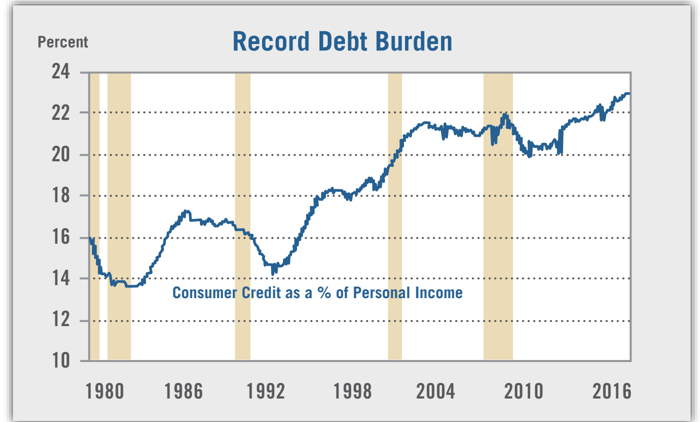
Kay Bahn joined Legacy in 2015 as a Support Services Specialist. Prior to working at Legacy, she was a Program/Transition Manager for Plexus and a volunteer within St. Mary's Catholic Education System. Kay attended the University of Wisconsin-Madison. Many of our clients first meet Kay at the front desk of our Neenah office when they call or visit.

Initially from Kaukauna, Wisconsin, and now living in Neenah, Kay and her family are very active members of the local community. Outside of work, Kay and her family love camping, traveling, and spending time with friends and family. She also enjoys attending her two daughters' club and school activities.

Kay holds one of Legacy's distinctive cross-departmental positions in which she has contact with many different employees and clients. Her coworkers at Legacy are especially grateful for her ability to handle the high volume of traffic our office sees on a daily basis. She is helpful, positive, and friendly. As a team player, Kay brings her upbeat, energetic personality to any meeting or project.

additional fiscal stimulus into 2018. That could impart a bigger boost to growth, which is already outpacing the economy's output capacity, in 2018. More important, the acceleration would probably be more than the Fed is willing to tolerate and quicken the pace of rate increases. In turn, that raises the odds of an earlier recession than otherwise.

One reason to worry is that consumers—the economy's main growth driver—would be most immediately affected by higher interest rates. It is the consumer that is the weakest link in the outlook. Not only have they spent at a faster pace than their incomes increased, depleting savings in the process, they have increasingly relied on debt, particularly credit cards, to finance purchases. Delinquency rates on installment loans are already on the rise and higher interest payments on these loans, which Fed rate hikes would quickly bring about, would further stretch household budgets and restrain spending. The stronger the economy looks in the immediate future, the quicker the Fed will apply the brakes to slow growth. For the expansion to continue beyond next year, the tortoise is a better bet than the hare. ■

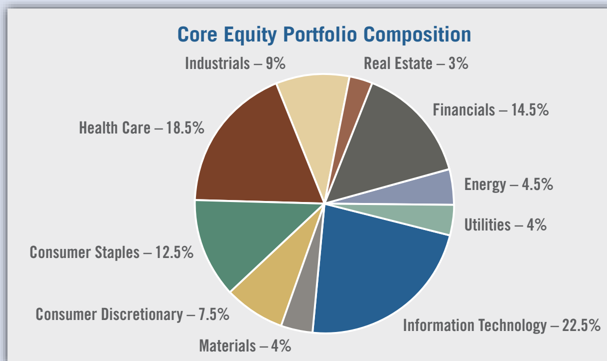


Featured Legacy Investment Portfolios

Core Equity Portfolio

The Core Equity Portfolio is designed to ensure broad participation in the equity market, with less than average market volatility, while effectively achieving investment goals for our clients. Our active valuation strategy and analysis focuses on individual stock selection in conjunction with economic sector discipline that looks beyond mainstream consensus to construct customized client portfolios.

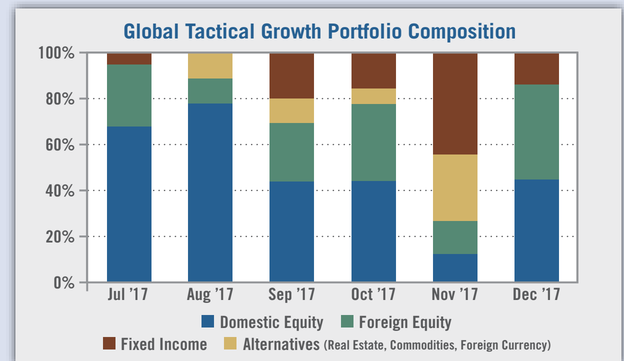
The chart below shows the sector weightings in the Core Portfolio as of December 31, 2017.



Global Tactical Growth Portfolio

The Global Tactical Growth (GTG) Portfolio is a disciplined, proprietary investment solution designed to maximize long-term investment returns with moderate risk. Legacy's goal is to position the GTG portfolio in the best performing asset classes (domestic equity, fixed income, foreign equity, foreign and domestic real estate, commodities and currencies) using all Exchange Traded Products.

The chart below shows the GTG asset allocation mix across four major asset classes over the past six months.



Past performance does not predict future results. Current and future results may be lower or higher than those referenced in this newsletter. Investments are not FDIC-insured, nor are they deposits of or guaranteed by a bank or any other entity. Investment return and principal value will fluctuate and investments may lose value.

To learn more, call us or visit www.lptrust.com.

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